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The End of LIBOR

Emily Fuller, Emma Russell, and Zoe Connor*

This article considers the current status of the London Interbank Offered Rate; whether it has a future in light of certain recent discussions in the market; and potential alternative rates that may be more suitable going forward.

The London Interbank Offered Rate ("LIBOR") is the average interbank interest rate published by ICE Benchmark Administration ("IBA") on which banks in the London market are prepared to lend to one another.

CURRENT STATUS OF LIBOR

Since 2014, when IBA became the benchmark administrator of LIBOR, an effort has been made to anchor banks' LIBOR submissions and rates to actual transactions as much as possible.

However, the market for unsecured wholesale term lending to banks is no longer sufficiently active and there is little prospect that these markets will become substantially more active in the future.

In a speech on July 27, 2017, Andrew Bailey (the Chief Executive of the Financial Conduct Authority (the "FCA")) discussed the unsustainability of relying indefinitely on a reference rate that does not have an active underlying market to support it.

There are currently 20 panel banks which make submissions on which the calculation of LIBOR is based. Panel banks are feeling increasingly uncomfortable about providing submissions based on judgments with so little actual borrowing activity. Any withdrawals of submissions from these 20 panel banks would further weaken the representativeness and robustness of the rate.

Currently English and European legislation gives the FCA the power to compel banks to contribute to LIBOR where necessary, but the FCA has stated that it would be reluctant to do this.

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A transition away from LIBOR is likely to take four to five years. The intention is for the panel banks to sustain LIBOR until the end of 2021.

ALTERNATIVES TO LIBOR

SONIA (Sterling Overnight Interbank Average Rate), which was first introduced in March 1997, has been suggested as an alternative to LIBOR as it is anchored on a more active market than LIBOR.

The Bank of England became the administrator for SONIA in April 2016 and is currently working on reforming the SONIA interest rate benchmark, with details of the new basis for methodology to be released in the spring of 2018.

Although there is an external advisory committee to assist the Bank of England with administering SONIA's benchmark rate, unlike LIBOR, SONIA does not rely on submissions from panel banks but rather is based on overnight funding rates in the sterling unsecured market. All transaction data is collected from the relevant market participants by the Bank of England. SONIA is a backwards looking rate, publishing rates at 9 a.m. each day for the previous day, whereas LIBOR is a forward looking rate and publishes at approximately 11:45 a.m. each day for maturity periods between a week to a year.

As LIBOR is quoted for several different currencies (being Pound Sterling, U.S. Dollar, Euro, Japanese Yen, and the Swiss Franc) and SONIA is Pound Sterling only, other jurisdictions are also looking for alternative rates.

In the United States, the Alternative Reference Rates Committee announced its choice of a broad Treasuries repo rate published daily by The Federal Reserve Bank of New York (the Broad Treasury Financing Rate, which is based on around $660 billion of trades daily and is the cost of overnight loans collateralized by U.S. government debt).

Other jurisdictions are also proposing overnight rates, with Japan proposing TONAR, which is considered to be relatively risk free. The Euro's EONIA rate and the Swiss SARON rate are also anchored in overnight rates.

WHAT NEXT?

The IBA has considered evolving LIBOR to a more centralized calculation, and thus not relying so heavily on panel submissions.

However, no further details have yet been published about this proposal, and in the meantime LIBOR continues to be based on a relatively inactive market.

The LMA loan documentation already provides alternative reference rates if the LIBOR screen rate is unavailable, although this is not a long term solution.

Any transition away from LIBOR is likely to take a considerable amount of time, whether that is implemented by amending existing contracts to reference an alternative rate, or amending the definition of LIBOR to replace the current methodology with alternative reference rates.

It is fair to say that those concerned about the future of LIBOR will be keenly awaiting the Bank of England's reforms to the SONIA benchmark on April 23, 2018.